IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT
OF PENNSYLVANIA

WRS, INC., d/b/a WRS MOTION PICTURE LABORATORIES, a corporation,

Plaintiff,

vs.

PLAZA ENTERTAINMENT, INC., a corporation, ERIC PARKINSON, an individual, CHARLES von BERNUTH, an individual and JOHN HERKLOTZ, an individual,

Defendants.

CIVIL ACTION

No. 00-2041

BRIEF IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AS TO THE LIABILITY OF DEFENDANT, JOHN HERKLOTZ

Plaintiff, WRS, Inc. (hereinafter referred to as "WRS") sued Plaza Entertainment, Inc. (hereinafter referred to as "Plaza") for the balance due on its account for the duplication of videocassettes. WRS sued John Herklotz (hereinafter referred to as "Herklotz"), Eric Parkinson (hereinafter referred to as "Parkinson") and Charles von Bernuth (hereinafter referred to as "von Bernuth") on their personal guaranties of the debt of Plaza to WRS.

Plaintiff's claim as to Herklotz is premised upon a document pleaded as Exhibit "B" to Plaintiffs Complaint. Herklotz signed this document and delivered it to WRS after he was told by Parkinson and von Bernuth that it was needed by WRS before WRS would begin duplicating a film know as "Giant of Thunder Mountain" of which Herklotz was the producer. Once WRS received the document signed by Herklotz it duplicated the films for Plaza. Herklotz does not deny signing the document. Rather, he defends on the basis that a subsequent agreement between WRS and Plaza entitled the Services Agreement, Exhibit "D" to Plaintiffs Complaint, altered the relationship between Plaza and WRS thus discharging his liability, WRS submits that the under the terms of his guaranty document, Herklotz authorized modifications of the Plaza WRS relationship such that the services agreement did not discharge Herklotz guaranty and he remains liable to WRS on his

Guaranty. Therefore, WRS respectfully submits Judgment should be entered in favor of WRS and against Herklotz, as to liability.

FACTUAL BACKGROUND

In 1996, Parkinson introduced a venture, Plaza, to WRS and began ordering the manufacturing videocassettes. In late April of 1998, Parkinson, for Plaza, submitted orders to WRS for the duplication of videocassettes for the film entitled "Giant of Thunder Mountain" (hereinafter referred to as "GTM") (Napor Deposition, Page 76) (Napor Affidavit). Because the request would entail a substantial increase in credit WRS would have to extend to Plaza, WRS sought to formalize its account relationship with Plaza and to secure a personal guaranty (Napor Deposition, Pages 73 – 75).

At that time, Herklotz was the CEO of Plaza (Herklotz Answer, Paragraph 8). Herklotz was also the producer of and had a personal financial interest in the film. In early May 1998, Parkinson and von Bernuth told Herklotz that Plaza had obtained a large order for GTM videos from Wal-Mart and in order to fulfill the order WRS required Herklotz's personal guaranty. (Herklotz Cross Claim Count V, Paragraph 2). (Pertinent portions of the Pleadings are attached as Exhibit "3" filed in conjunction with the Brief). On May 6 1998, John Purdy of WRS faxed to Parkinson the WRS Credit Application (Napor Affidavit) and the blank form Guaranty to Herklotz (Napor Affidavit). Herklotz immediately signed the Guaranty and returned it to WRS (Napor Affidavit) (Herklotz Answer, Paragraph 8. In reliance upon Herklotz's Guaranty, WRS filled the Plaza order for videocassettes of GTM and, otherwise, continued to do business with Plaza.

On October 12, 1998, WRS , Parkinson , Plaza and von Bernuth signed the Services Agreement pleaded as Exhibit "D" to Plaintiffs Complaint. After the execution of the Services Agreement, WRS took over the billing and collection of receivables and set a lock box account. Unfortunately, the receivables that Plaza purported to have were difficult, if not impossible, to collect (Napor Deposition, Pages 121 – 123). Ultimately, the relationship between WRS and Plaza ended.

Despite discussions regarding the potential for payment of the receivables, WRS commenced this action.

ARGUMENT

Herklotz's Obligation To WRS Was Not Discharged By The Services Agreement.

In considering a Motion for Summary Judgment, the Court must view the facts in a light most favorable to the non-moving party. Doe v. County of Centre, 242 Fed.3rd 437 (3rd Circuit 2001). Summary Judgment may be appropriately entered only where there is no genuine issue of material facts and the moving party is entitled to Judgment as a matter of law. F.R.C.P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed 2nd 265 (1986). Where the appropriate record exists, the Court may not only deny the moving party's Motion for Summary Judgment, but may also enter Judgment for the non-moving party. CW Gov't Travel, Inc. v. United States, 63 Fed. Cl. 459; (2005). WRS respectfully submits that Judgment should be entered in favor of WRS and against Herklotz for, as for liability.

Because the document he signed does not contain the language prescribed by 8 P.S. §1, Herklotz is a surety directly liable to WRS for the Plaza debt rather than a guarantor. Herklotz claims that he was not aware of the services agreement. There is no evidence in the record that he knew of the services agreement other than to the extent that Parkinson's and von Bernuth's knowledge of it is imputed to Herklotz.

The obligation of the surety may be discharged by a material modification of the debtor/creditor relationship to which the surety did not consent. Continental Bank v. Axler, 353 Pa.Super 409, 510 A.2d 726 (1986). Schroyer v. Thompson, 262 Pa.Super 282, 105 A.2d 274 (1918) However, assuming lack of knowledge, the issue is whether under the document he signed, Herklotz consented to material modifications of the creditor/debtor relationship such that his promise to pay the Plaza debt was unaffected notwithstanding the change in the WRS /Plaza relationship. Meeting House Lane, Ltd. v. Melso, 427 Pa.Super 118, 628 A.2d 854 (1993).

In interpreting the Herklotz guaranty, the rules of construction differ depending on whether Herklotz is considered a gratuitous surety or a compensated surety. When determining whether the gratuitous surety consented to modification in the language of the contract of surety, the terms of the contract are strictly construed in favor of the surety. Manufacturers & Merchants Bldg. & Loan Ass'n v. Willey, 321 Pa. 340, 183 A. 789 (1936). . Where a surety is a compensated surety, the surety agreement is construed in favor of the obligee (here "WRS'). Fiurama v. American Surety Co., 346 Pa. 584, 31 A.2d 283 (1943); Garden State Tanning, Inc. v. Mitchell MFG Group, Inc., 273 Fed.3rd 332 (3rd Circuit 2001). The court when interpreting the commitment of a compensated surety the court may construe the agreement in favor of the oblige beyond the precise terms of the contract. Wise Inv. v. Bracy Contr Inc., 232 Fed.2d 390 (E.d. Pa 2002).

Thus, in determining whether Herklotz consented to the modification of the debtor/creditor relationship by executing the guaranty document, if Herklotz, is a gratuitous surety the terms of the contract are construed strictly in his favor. Barrat v. Greenfield, 137 Pa.Super 310, 9 A.2d 188 (1939). However, if Herklotz is a compensated surety, the language of his guaranty is construed n favor of WRS.

A professional surety company is considered a compensated surety because it obtains a fee for its services. Bank of Nova Scotia v. St. Croix Drive In Theatre Services, 728 F.2d 177 (3rd Circuit 1984). However, Pennsylvania law does not limit compensated sureties to professional surety companies. An officer or sole shareholder of a corporation who provides a guaranty to induce a creditor to extend a line of credit is considered a compensated surety. First National Bank of East Conenaugh v. Davies, 315 Pa. 59, 172 A.2d 296 (1934). Similarly, other officers and directors, who are otherwise interested in the transaction, are also considered compensated sureties. In Re: Cancelmo, 308 Pa.128, 162 A 454 (1932); J.F. Walker Co., Inc. v. Excalibur Oil Group, 2002 Pa.Super 39, 792 A.2d 1269 (2002). The trend as recognized by Third Circuit is away from the application of the strict construction in favor of the surety where the surety is motivated by potential profit in giving his guaranty. Garden State Tanning, Inc. v. Mitchell Manufacturing Group, Inc. s*upra*. More recently, the trend was recognized in Pennsylvania Superior Court in Fessenden Hal of PA v. Mountainview Specialties, Inc., 2004 Pa.Super 456, 863 A.2d 578 (2004) where the Court found an individual without whose guaranty the creditor would not have extended credit to be compensated surety which holding was in accord with McIntyre Square Associates v. Evans, 2003 Pa.Super 214, 822 A.2d 446 (2003) and J.F. Walker *supra*.

Here, Herklotz had a personal financial interest in GTM. He was advised by Parkinson and von Bernuth that WRS would not manufacture the dubs of GTM without Herklotz's personal guaranty. At some point during these transactions, Herklotz was the CEO of Plaza. Clearly, Herklotz did not provide his Guaranty out the familial or neighborly affection mentioned in Garden State Tanning *supra*. Rather, Herklotz was motivated to provide a Guaranty in order to sell cassettes of his film. In fact, Herklotz has asserted a Cross Claim against Parkinson and von Bernuth for the loss incurred by their mishandling of the sales of GTM videos by failing to properly advertise and promote the sale of the videos. Thus, Herklotz was a compensated surety. In determining whether by signing the guaranty document Herklotz consented to material modification of the Plaza/WRS relationship, the Court must construe the language in favor of WRS. Central-Penn National Bank of Philadelphia v. Tinkler, 351 Pa. 123, 4 A.2d 389 (1945); Restatement of Security Session 128 Comment C.

It should be pointed out, however, that even if Herklotz was a gratuitous surety, he could execute a document that sufficiently expressed consent to modifications. Reliance Insurance Company v. Penn Paving Company, Inc., 557 Pa. 439, 734 A.2d 833 (1999); Robert Mallery Lumber Corp v. B & F Associates, Inc., 294 Pa.Super 503, 440 A.2d 579 (1982). Thus, even if Herklotz is considered not to be a "compensated guarantor", interpreting the Guaranty Agreement to determine Herklotz's intention, clearly reveals his consent to subsequent modifications of the creditor/debtor relationship whether construed in favor of WRS or strictly construed in favor of Herklotz.

The document Herklotz signed establishes his unconditional and continuing commitment to be continuously and directly liable to WRS for the Plaza debt regardless of extensions and modifications and regardless of whether he was given notice of any changes with his liability to conclude when he chose to terminate his liability by providing notice. The document begins with the following phrase:

> To induce you to sell merchandise and to extend credit to debtor… unconditionally guaranties complete and prompt payment when due of any indebtedness, which may at the present time or at any time hereafter and from time to time be owing to you by debtor.

The language continues:

> This guaranty is direct and unconditional and may be enforced without first resort to any other right, remedy or security, which you have. The undersigned waives notice of acceptance hereof all prior notice of default and a demand for payment.
>
> You shall have the unrestricted right to renew, extend, modify and/or compromise any indebtedness and to accept, substitute, surrender or otherwise deal with any collateral, security or other guaranties without notice to the undersigned and without effecting the obligation of the undersigned hereunder.
>
> This guaranty shall continue at all times and shall remain in full force and effect until such time as you receive from the undersigned by registered mail written notification of revocation.

The language in the Herklotz document contemplated an ongoing relationship during which WRS in reliance upon his guaranty would sell merchandise and/or extend credit to Plaza. The language anticipated extensions and modifications of the debtor/credit relationship to which Herklotz agreed could take place without restriction or notice to him and without affecting his liability. WRS, therefore, respectfully submits that to the extent that the Services Agreement materially modified the relationship between WRS and Plaza (which WRS argues was not materially modified) Herklotz consented to such modification by the Guaranty delivered to WRS. Therefore, the fact that the Services Agreement may have modified the relationship between WRS and Plaza does not serve to discharge Herklotz's liability.

Furthermore, even if the Court were to find the guaranty did not contain Herklotz's consent to the modification without notice of the creditor/debtor relationship between WRS and Plaza, the Services Agreement did not materially modify the Plaza/WRS relationship contemplated by the Herklotz Guaranty.

As can be seen by the language of the Guaranty, Herklotz contemplated an ongoing account relationship consisting of both present and future indebtedness. The document was not limited in any way to the expense of duplicating the video of GTM, although Herklotz certainly knew before signing that those duplications would not be manufactured without his Guaranty. Because Herklotz had the opportunity to limit his obligation when he submitted the signed document and did not take that opportunity to do so, Herklotz is bound by the document he signed. Denlinger v. Dendler, 415 Pa.Super 164, 608 A.2d 1065 (1992).

For there to be a material modification in the debtor/creditor relationship requires an agreement substantially different from the original agreement for which this surety accepted liability. J.F. Walker Company, Inc. v. Excalibur Oil Group, *supra.* This begs the question: Of what agreement did Herklotz accept liability? From the Guaranty signed, it was an open account arrangement in which WRS would manufacture video to be paid for by Plaza from funds earned through the sale of the videos, which sales would be enhanced by Plaza.

WRS submits that the arrangement under the services agreement did not materially modify the debtor/creditor relationship and did not discharge Herklotz even as a gratuitous surety. However, because of Herklotz's was a compensated guarantor, Herklotz obligation would not be discharged absent a showing that she services agreement substantially increased Herklotz's risk as a guarantor. McClelland v. New Amsterdam Casualty Company, 322 Pa. 429, 185 A. 198 (1936); Continental Bank v. Axler, *supra*.

While Herklotz argues that the Services Agreement increased his risk, this is at a minimum a genuine issue of material facts prohibiting the entry of Summary Judgment. Furthermore, a review of the Services Agreement, WRS submits, demonstrates that Herklotz's risk was not increased from that contemplated. Herklotz guaranty contemplated an ongoing account relationship. The Services Agreement reduced Herklotz's risk by providing collateral and providing a mechanism to assure application of payment to the debt that he guarantied and by adding as guarantors Parkinson and von Bernuth (against who Herklotz has now maintained his Cross Claim for contribution). The Services Agreement also provided an incentive in reduction of the outstanding debt if Plaza became current in its receivables. Based upon a review of the Services Agreement, WRS submits that the Services Agreement substantially reduced Herklotz's risk. Herklotz has failed to demonstrate that the Services Agreement in any way increased his risk. Thus, even Herklotz is found not to have consented to material modifications by signing the guaranty, since his risk was not increased by the services agreement, his liability as a surety has not been discharged.

It is also significant that Herklotz, executed an unconditional guaranty which deprives him of various defenses that he might otherwise have had against payment of the debt. For example, the failure of WRS to collect accounts receivable in which the debt can be paid is not a defense to liability of an unconditional guarantor. McKeesport National Bank v. Rosenthal, 355 Pa.Super 291, 513 A.2d 434 (1986) An unconditional guarantor is bund by the commitments of the debtor. CitiCorp N.A. v. Thorton, ___Pa.Super___, 707 A.2d 536 (1998). Nor is an unconditional guarantor's debt excused by the creditor's failure to perfect a security interest. Fireman's Fund v. Joseph J. Biafore, Inc., 526 F.2d 170 (3rd Circuit 1975). The effect of the unconditional guaranty is to limit the guarantor's defenses to payment or performance. Continental Leasing v. Libo, 272 A.2d 193, Pa.Super (1970). Since Herklotz has not pleaded either of these Defenses, he has no defense.

III. CONCLUSION

In summary, Herklotz's obligation as surety has not been discharged. Rather, he remains liable to WRS for the full amount of the outstanding obligation of Plaza. WRS respectfully submits that its

Motion for Summary Judgment should be granted and judgment for entered in favor of WRS, Inc and against Defendant John Herklotz.

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